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M E M O R A N D U M

January 30, 2013

TO: Representative Randy Fischer

FROM: Kori Donaldson, Research Associate II, (303) 866-4976

SUBJECT: Use of College Opportunity Fund to Determine Borrowing Limits Under the Higher Education Revenue Bond Intercept Program

Summary

This memorandum responds to your request for information about the College Opportunity Fund (COF) program and how appropriations under the program relate to borrowing limits under the Higher Education Revenue Bond Intercept Program (intercept program). The memo first provides background about how higher education is funded, including an explanation of COF stipends and fee-for-service contracts. It continues with a discussion of the authority granted to higher education institutions to issue debt and an explanation of the intercept program. The memo concludes with a discussion about the concern with the current borrowing limit under the intercept program, a compromise proposed by Department of Treasury to the current borrowing limit, and potential committee action.

State Funding for Higher Education

During the 2004 legislative session, the Colorado General Assembly changed the mechanism through which higher education costs associated with educational services are funded. In lieu of a direct appropriation to each public institution of higher education, Senate Bill 04-189 established the College Opportunity Fund program. Beginning in academic year 2005-06, the program provided annual funding for higher education through two mechanisms: tuition stipends for eligible students and fee-for-service contracts.¹ Participation in the program is optional; however, all

¹Section 23-18-101, et. seq., C.R.S.

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ten governing boards overseeing public colleges in the state have participated in the program since its inception. In addition, three private universities also participate in the program.²

The Department of Higher Education (DHE) annually submits a budget request to the Joint Budget Committee for COF stipend and fee-for-service payments to public institutions of higher education; the budget request amounts are based on enrollment projections. The General Assembly annually appropriates funds for COF stipends and fee-for-service contracts to each participating governing board. In turn, governing boards are authorized to allocate funding among their respective institutions. Current law allows the stipend amount to vary based on the availability of state funds, and the state is permitted to reduce the stipend amount mid-year. In practice, once stipends and fee-for-service contracts are paid to a higher education institution, the institution makes no distinction between these fund sources.

College Opportunity Fund stipends for undergraduate resident students. The COF provides stipends for undergraduate resident students to attend public colleges and participating private colleges in Colorado. The eligibility requirement is higher for students attending a participating private college. In addition to proving Colorado residency, a student attending a private college must be a graduate of a Colorado high school, demonstrate financial need (as determined by his/her eligibility for a federal Pell Grant), and not be pursuing a degree in theology. The stipend amount is established annually through the regular budget process and is the same for all students attending public colleges. The stipend amount for students attending participating private colleges is one-half of the established per credit hour stipend. The stipend may only be used for approved undergraduate courses.³ The stipend may not be applied to more than 145 credit hours, unless a waiver is sought and received from the participating college or the Colorado Commission on Higher Education. The stipend amount is intended to offset the cost of in-state tuition. The FY 2012-13 appropriation for COF stipends was \$1,806 per eligible student, or \$62 per credit hour, for a projected 141,905 eligible students enrolled in state public colleges; and \$930 per eligible student, or \$31 per credit hour, for a projected 1,160 eligible students enrolled in participating private colleges.

Fee-for-service contracts. Fee-for-service contracts were established under the COF program to fund educational services that are not funded through COF stipends such as graduate programs or services in rural areas or communities. The DHE entered into performance contracts with the participating colleges in 2006. These contracts are amended on a yearly basis. Typically, the DHE works with representatives of the state institutions of higher education each fall to determine the total award amount for each governing board under the COF program. The department and the General Assembly then determine the total award amount and the COF stipend award amount based on enrollment projections. Thus, the fee-for-service contract award amount for each institution is the difference between the total award amount and the COF stipend award amount. The FY 2012-13 appropriation for fee-for-service contracts was \$229.7 million.

²University of Denver, Regis University, and Colorado Christian University

³Rather than identifying eligible courses, the law outlines courses that are not eligible for the stipend. The list of precluded courses includes Advanced Placement courses; off-campus, extended campus, or continuing education courses; and International Baccalaureate courses.

Classification of COF revenue for purposes of TABOR and higher education institution enterprise status. In addition to establishing the COF program, SB 04-189 also made changes to law resulting in the classification of most public higher education institutions as enterprises under the definition of TABOR. Specifically, state agencies that have been granted enterprise status, including most higher education institutions, are permitted to issue revenue bonds to finance capital projects. Additionally, state enterprises are exempt from the requirement in the Colorado Constitution to seek voter approval prior to issuing multi-year fiscal debt. Enterprise status is statutorily granted to government-owned businesses so long as they receive less than 10 percent of their annual revenue in grants from state and local government sources combined.⁴ Pursuant to current law, the amount of COF stipend received by a state institution of higher education on behalf of eligible undergraduate students does not constitute a grant for the purposes of TABOR.⁵ According to a review of the COF program conducted by the Western Interstate Commission on Higher Education, the exemption of COF stipends from the definition of a grant for the purposes of TABOR is predicated on the idea that the COF stipend is being provided to students rather than to the colleges. The Legislative Audit Committee annually determines, in conjunction with the DHE, which higher education institutions qualify for enterprise status.

Higher Education Revenue Bond Intercept Program

As discussed earlier in this memorandum, a higher education institution that has been granted enterprise status is permitted to issue revenue bonds. The bonds may be backed by the institution's credit rating, or the institution may opt to participate in the Higher Education Revenue Bond Intercept Program, which allows an institution of higher education to bond for capital projects using the state's credit rating. The intercept program directs the State Treasurer to make bond payments of principal and/or interest on behalf of a state-supported institution of higher education in the event a higher education institution does not make a scheduled payment, unless a higher education institution adopts a resolution stating that it will not accept such payment prior to the issuance of the bonds for a project.⁶ Historically, many state-supported institutions of higher education have issued bonds backed by revenue sources, such as student fees.

Borrowing limit established under intercept program. The intercept program establishes a limit on the amount of debt an institution may issue under the program. The annual debt service payment of any new issuance combined with all other issuances subject to the intercept program cannot exceed 100 percent of an institution's prior year COF fee-for-service contract amount.⁷ The intercept program also sets parameters on the amount and type of cash funds used to repay borrowing. Table 1 shows the COF stipend and fee-for-service contract amount appropriated to each governing board of higher education in FY 2012-13. It also lists the remaining amount each governing board can borrow under the program, based on prior issuances.

⁴Colorado Constitution, Article X, Section 20, (2)(d)

⁵Section 23-18-202 (7), C.R.S.

⁶Section 23-5-139 (1)(a), C.R.S.

⁷Section 23-5-139 (1)(b)(I), C.R.S.

Table 1
FY 2012-13 COF Program Appropriation and Borrowing Limits
Under the Intercept Program

Governing Board	COF Stipend Amount	Fee-for-Service Contract/Borrowing Limit	Total	Remaining Intercept Capacity
Board of Governors of the Colorado State University System	\$39,471,060	\$64,508,537	\$103,979,597	\$575,923,085
Regents of the University of Colorado	50,805,900	90,365,444	141,171,344	N/A*
State Board for Community Colleges and Occupational Education	101,025,900	15,164,107	116,190,007	223,789,969
Trustees of Adams State College	2,896,020	8,013,091	10,909,111	54,928,181
Trustees of Colorado Mesa University	12,103,020	6,527,830	18,630,850	0
Trustees of the Colorado School of Mines	4,910,400	10,862,182	15,772,582	4,453,858
Trustees of Fort Lewis College	4,162,680	4,896,159	9,058,839	See note**
Trustees of Metropolitan State College of Denver	31,220,100	5,761,905	36,982,005	36,727,951
Trustees of Western State College	2,377,080	6,737,362	9,114,442	10,610,661
University of Northern Colorado	14,971,140	16,885,955	31,857,095	193,742,805

Source: FY 2012-13 Annual Long Bill, DHE, Fort Lewis College, and Department of Treasury

* N/A = This institution does not borrow under the intercept program.

** The remaining intercept capacity for Fort Lewis College has not been estimated by the Department of Treasury. The annual debt payment limit is estimated to be about \$4.5 million.

Concerns with Current Borrowing Limit

During the December 2012 annual Capital Development Committee (CDC) hearings, a concern was raised with the current borrowing limit under the intercept program. Specifically, a representative of Colorado Mesa University explained that as enrollment increases at an institution of higher education, the COF stipend appropriation amount is increased and the fee-for-service appropriation amount is decreased. This results in a smaller borrowing capacity for growing institutions.

Compromise proposed by the Department of Treasury. Following the December CDC hearings, a representative of the Department of Treasury met with the chief financial officers from various institutions of higher education to discuss concerns with the existing borrowing limit under the intercept program. In lieu of using the fee-for-service contract award amount to determine the borrowing limit under the intercept program, the Department of Treasury proposes using a credit and coverage test to determine the eligibility of each governing board to issue additional debt. The proposed credit and coverage test is comprised of two factors, including: (1) a governing board must have a credit rating of A or better from at least two of the three major credit rating agencies

(Moody's, Standard and Poors, and Fitch); and (2) a governing board's debt service coverage ratio must meet or exceed 200 percent of the governing board's net revenues. In other words, a governing board will have to show that it has at least twice the amount of revenue needed for current and future debt payments available and unobligated. Under the proposed compromise, the State Treasurer would have the authority to exempt a governing board from the requirements of the credit and coverage test under certain circumstances, such as refinancing existing debt that will result in cost savings.

Action required by the Capital Development Committee. Legislation is required if the CDC is interested in implementing a change to the current borrowing limit under the intercept program.